1020 Nineteenth Street NW
Suite 700
Washington, DC 20036
303 672-5839
fax: 202 296-5157

John W. Kure
Executive Director - Federal Regulatory

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

December 8, 2000

Magalie Roman Salas, Secretary
Federal Communications Commission
445 12th Street, SW, Room TW-A325
Washington, DC 20554

Re: CC Docket Nos. 96-98 and 99-68
Implementation of the Local Competition Provisions of the Telecommunications Act of 1996: Inter-Carrier Compensation for ISP-Bound Traffic

Dear Ms. Salas:

On December 8, 2000, Melissa Newman, Robert McKenna and I met with Rebecca Beynon, legal advisor to Commissioner Harold Furchtgott-Roth. During the meeting we discussed the items shown on the attached handout. The Qwest White Paper mentioned in the handout is also attached.

In accordance with Section 1.1206(b)(2) of the FCC's Rules, an original and two copies of this letter are being filed with your office for inclusion in the public record.

Acknowledgment and date of receipt of this submission are requested. A duplicate of this letter is provided for this purpose. Please call if you have any questions.

Sincerely,

John W. Kure by

Attachments

cc: Rebecca Beynon, Dorothy Attwood, Kathy Brown, Tamara Preiss, Adam Candeub, Rodney McDonald

Reciprocal Compensation for ISP-Bound Traffic

CC Dkt. Nos. 96-98 and 99-68

Ex parte

December 8, 2000

Melissa Newman, Robert McKenna and John Kure,

Qwest

The Commission must recognize and address the escalating problem of reciprocal compensation for ISP-bound traffic

ILECs are paying CLECs approximately $2.5 Billion for 2000 in reciprocal compensation payments.

Minutes in dial-up access to the Internet continue to grow (almost 50% per year) even with the migration to DSL and cable modem service.

Even if per minute rates decline, ILECs will pay more money to CLECs in reciprocal compensation billings than we are now due to exponential growth in minutes, thus exacerbating the situation.

As a legal matter bill and keep is the appropriate compensation mechanism for ISP-bound traffic

The FCC has the authority and responsibility to establish reasonable interconnection rules among carriers.

The FCC correctly concluded in the Local Competition Order that traffic, which is not terminated in the local exchange, is not subject to section 251(b)(5). Thus, interexchange traffic is not subject to reciprocal compensation because the caller pays the long distance carrier, not the originating LEC, for the call. Thus, the originating LEC receives no revenue from the caller and must recover its costs for terminating the call from the IXC.

Internet dial-up traffic is akin to long distance traffic in that the caller pays the ISP, not the originating LEC, for the call. Under fundamental economic principles, the ILEC does not cause the CLEC to incur costs, rather the ISP and the end user. Thus, the LEC and CLEC involved should recover their costs from their own customers, i.e., the ISP and end user.

QWEST'S WHITE PAPER

Transition to bill and keep should be relatively short

An 18-month transition is sufficient to allow for the complete termination of reciprocal compensation payments.

CLECs have been on notice for two years that reciprocal compensation payments for Internet dial-up traffic could end.

The financial markets have already discounted reciprocal compensation revenues to CLECs. A permissive solution is of no benefit because it continues the regulatory uncertainty surrounding reciprocal compensation.

New interconnection agreements negotiated by CLECs and ILECs should immediately go to bill and keep, unless the parties agree otherwise.

"Evergreen" clauses

During the transition the ratio caps should be low

A 12:1 ratio generally does nothing more than preserve the status quo of first year payments; it does not result in any reduction of payments.

Over 90% of the traffic exchanged between ILECs and CLECs is sent from the ILEC to the CLEC. Without a low ratio cap, CLECs will *continue* to have the incentive to target exclusively customers who terminate but do not originate traffic to reach the cap.

> Targeting customers in this fashion provides no "value add" to the telecommunications sector or to consumers.

State orders for bill and keep must be respected

Three Qwest states have ordered bill and keep for ISP-bound traffic largely on the basis that reciprocal compensation is an arbitrage opportunity for the CLECs that is unjust.

Arizona, Colorado, Iowa

It would be a step backward if the Commission created a situation, even during the transition, which would require these and other states who have appropriately ordered bill and keep to revisit that issue.

A Permissive Solution is Meaningless

Under the current "federal" regime, states are free to arbitrate reciprocal compensation decisions as they see fit. Based on press accounts, the draft order changes nothing. It is simply allowing the states to continue to do what they are already doing today. What is the point?

Actually, the draft order as we understand it makes the situation worse.

> Several states have ordered bill and keep without a transition period. Does this draft order require a transition first before a state could order bill and keep?
>
> Moreover, payments to CLECs could rise.

Transiting traffic is not subject to bill and keep

When a LEC hands the traffic from one LEC to another, there is no end user to bill, thus, under a bill and keep approach, the transiting carrier has no business relationship with the end user generating the traffic and would receive no payments for handing off traffic from either the end user or the originating carrier.

The Commission's rules must not preclude a transiting carrier from being compensated from the originating carrier.

A Legal Roadmap for Implementing A Bill and Keep Rule for All Wireline Traffic

Prepared by Qwest Communications International, Inc.

For Inclusion in CC Docket Numbers 96-98 and 99-68
Implementation of the Local Competition
Provisions of the Telecommunications Act of
1996: Inter-Carrier Compensation for
ISP-Bound Traffic

DATE 11-22-00

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EXECUTIVE SUMMARY

The Commission is continuing to struggle with the conundrum posed by what is called "ISP reciprocal compensation" — the massive diseconomies created when a CLEC serves a large number of Internet Service Providers and establishes a huge subsidizing revenue stream from a neighboring ILEC solely on account of one-way connections between the ILEC's customers and the Internet. While the Commission has been considering this issue for some time, its current deliberations are guided by the Court of Appeals decision in *Bell Atlantic*, in which an earlier Commission determination that ISP reciprocal compensation was not subject to the reciprocal compensation provisions of section 251(b)(5) of the Telecommunications Act was reversed for lack of sufficient reasoned decision making.

This paper examines the Commission's options in dealing with the ISP reciprocal compensation issue in light of *Bell Atlantic*. We have proposed legal arguments designed to support the economic and public policy analyses that document that the best method of treating inter-carrier compensation in the context of ISPs is what is called "bill and keep," where both carriers participating in a partnership to provide a connection between the ISP customer of one carrier and the end user customer of the other bear their own costs. As we demonstrate, there are various means of approaching a bill and keep regime in the wake of the *Bell Atlantic* decision. One legal quandary that we address is the fact that the Commission has suggested that section 252(d) of the Act permits mandatory bill and keep for local traffic *only* when traffic between two carriers is relatively in balance; thus, in the case of ISP reciprocal compensation, it would seem potentially anomalous to order bill and keep for the express reason that the traffic is so seriously out of balance as to create public policy dangers. Nevertheless, we conclude that proper analysis fully supports a regulatory structure in which ISP reciprocal compensation is handled via bill and keep, either alone or in conjunction with bill and keep for traffic more clearly identified as local in nature. Indeed, we suggest that this approach is possible even if the Commission does not revisit its rule concerning the need for traffic to be balanced, although it certainly may do so.

This paper presents two approaches which provide a legal foundation for a bill and keep regime for ISP and local traffic:

- ISP traffic can be treated as non-local in nature and not subject to the reciprocal compensation provisions of section 251(b)(5) at all. This is the approach initially taken in the order reversed in *Bell Atlantic*. However, review of the record and the *Bell Atlantic* decision demonstrates that the Commission can quite comfortably conclude that, consistent with the directions of the Court and with reasoned decision making, delivery of ISP traffic to a CLEC is not subject to the reciprocal compensation provisions of section 251(b)(5) because delivery of Internet-bound traffic to the ISP does not constitute either transport or termination of that traffic. A bill and keep structure can still be made applicable to other local traffic pursuant to the provisions of section 251(b)(5).

- ISP traffic can be treated as subject to 251(b)(5), but still subject to a bill and keep regulatory structure. This conclusion does not require that the Commission abandon its prior analysis that section 252(d)(2) requires that costs be reasonably in balance as a prerequisite to ordering bill and keep as a regulatory requirement. Bill and keep for ISP traffic pursuant to section 252(d)(2) can be ordered simply on the recognition that, in the case of ISP traffic, the originating LEC is not the cost causer in any cognizable economic sense. So long as the structure permits the CLEC to recover its costs from the entity with which such costs are "associated" — the ISP which is its customer — bill and keep would be consistent with the Act.

The Commission could also implement bill and keep for ISP traffic by denying reciprocal compensation for carriers that offer service only to a limited number of customers based on Internet arbitrage, and by forbearing from enforcing the reciprocal compensation pricing rules in section 251(d)(2). While these are discussed in this paper, they are not optimal and we do not recommend that they be adopted.

A LEGAL ROADMAP FOR IMPLEMENTING A BILL AND KEEP RULE FOR ALL WIRELINE TRAFFIC

For several years, the Commission has been wrestling with the problem of "ISP reciprocal compensation" — whether and how the Commission's rules implementing 47 U.S.C. § 251(b)(5) apply to the dial-up connections between Internet service providers ("ISPs") and their subscribers when two or more carriers collaborate to provide such connections. Many parties have sought to exploit the current rules by creating ISP-only carriers that exist primarily to tap into the significant flow of reciprocal compensation payments that these incoming-only customers generate, creating a massive transfer of wealth to these carriers from the ratepayers of the incumbent LECs. The current compensation regime distorts the marketplace, discouraging carriers from building networks to serve the residential customers who initiate these dial-up connections, and rewarding carriers for restricting their services to ISPs exclusively. Under the present rules, incumbent LEC ratepayers subsidize the carriers serving ISPs with hundreds of millions of dollars a year, regardless of whether those ratepayers use the Internet themselves.

The Commission is well aware of these harms, which have been documented in multiple rounds of comments and ex partes over the past four years, and which have spawned extensive debate on Capitol Hill as well. The Commission took a first step toward addressing these problems last year by ruling that ISP dial-up calls transmitted from one LEC to another fall outside section 251(b)(5) because they do not terminate locally with the ISP, *see* Declaratory Ruling and Notice of Proposed Rulemaking, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996: Inter-Carrier Compensation for ISP-Bound Traffic*, 14 FCC Rcd 3689 (1999) ("*Reciprocal Compensation Declaratory Ruling*"). However, the D.C. Circuit vacated and remanded this initial effort because it found that the Commission had not adequately explained its reasoning. *See Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) ("*Bell Atlantic*").

Qwest understands that the Commission is using this remand as an opportunity to explore comprehensive legal and practical solutions to the question of ISP reciprocal compensation. One solution the Commission reportedly is considering is a "bill and keep" rule for ISP dial-up traffic, or for local and ISP dial-up traffic alike. As Qwest and other parties have demonstrated in their comments and ex parte presentations to the Commission, given the current ESP exemption from carrier access charges, a bill and keep compensation structure represents the economically optimal solution to the problem of ISP reciprocal compensation. The purpose of this paper is to articulate and analyze legal arguments that would support implementation of a bill and keep structure for Internet-bound traffic, either in isolation or together with other kinds of wireline traffic.

I. General Approaches to Implementing Bill and Keep.

A bill and keep rule for Internet-bound traffic could be grounded on one of two sources of authority. If the Commission deems ISP dial-up calls non-local or otherwise outside section 251(b)(5), any intercarrier compensation rule would have to be based on the Commission's general authority under 47 U.S.C. § 201. If, on the other hand, Internet traffic were deemed to be within the ambit of section 251(b)(5), then any bill and keep transport and termination rates for that traffic (or some broader range of traffic encompassed by section 251(b)(5)) would have to be set in accordance with 47 U.S.C. § 252(d)(2). Section 252(d)(2) prevents a state commission from approving a section 251(b)(5) reciprocal compensation arrangement unless the arrangement "provide[s] for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination . . . of calls that originate on the network facilities of the other carrier," with the costs determined "on the basis of a reasonable approximation of the additional costs of terminating such calls." 47 U.S.C. § 252(d)(2)(A)(i), (ii).

While section 252(d)(2) expressly does not "preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)," *id.* § 252(d)(2)(B)(i), any regulatory regime that imposes bill and keep for out-of-balance traffic will need to address whether the scheme "afford[s]" or "provide[s] for the mutual . . . recovery by each carrier of costs." The Commission suggested in its *Local Competition Order* that some degree of balance generally is necessary, ruling that states may impose mandatory bill and keep arrangements only where traffic between carriers is "roughly balanced." First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 16054-55 ¶¶ 1111-13 (1996) ("*Local Competition Order*"). Of course, the Commission could squarely amend this rule, but ultimately the challenge before the Commission with respect to fashioning a bill and keep regime for ISP traffic will be to ensure that any such regime complies with the principles set forth in the body of section 252 itself. The proposals discussed below lay out ways in which the Commission could proceed.

The very reason the Commission is considering action with respect to ISP dial-up is that the traffic flows between incumbent and competitive carriers *are* out of balance.[1/] Thus, the best way for the Commission to implement bill and keep would be to reaffirm its conclusion that Internet-bound calls do not come within the scope of section 251(b)(5) at all; then, any

[1/] Whereas the imbalance between ILEC and CLEC traffic flows for Internet-bound calls arises solely as a result of the CLECs' regulatory arbitrage, the asymmetrical traffic flows between wireline and CMRS networks are entirely real, resulting from differences in network costs, pricing, and customer usage preferences. As discussed below, this inherent traffic intercarrier compensation rule adopted for such traffic would not be bound by the limitations of section 252(d)(2). Such an approach would require a thorough analysis of the D.C. Circuit's decision in *Bell Atlantic v. FCC*, but would not otherwise be vulnerable to challenge under the Act. The Commission could then subject some or all of the remaining local traffic to a bill and keep structure pursuant to sections 251(b)(5) and 252(d)(4).

If, on the other hand, the Commission were to modify its earlier conclusion concerning the non-local nature of ISP-bound traffic (or were to revisit its conclusion that 251(b)(5) is limited to local traffic) the Commission could still implement a bill and keep compensation structure under section 251(b)(5). The Commission could find that under ordinary principles of cost causation, the costs of ISP dial-up are "associated," for purposes of section 252(d)(2), with serving the ISP, not its subscribers. Alternatively, the Commission could hold that carriers that have intentionally limited the customers they serve simply to create traffic imbalances are not entitled to "reciprocal" compensation arrangements under section 251(b)(5). Finally, the Commission could decide under its section 10 authority, 47 U.S.C. § 160(a) that it is appropriate to forbear from applying section 252(d)(2) to ISP-bound traffic. Each of these approaches, however, presents its own set of issues that the Commission would have to address before proceeding.

Whichever route the Commission chooses, it clearly has jurisdiction to act. Whatever other concerns the D.C. Circuit had in *Bell Atlantic*, the court expressly reaffirmed the Commission's end-to-end methodology for determining whether traffic comes within its regulatory jurisdiction: "There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is

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imbalance between wireline and CMRS networks suggests that CMRS traffic should *not* be jurisdictionally interstate." *Bell Atlantic*, 206 F.3d at 5. The D.C. Circuit further acknowledged that, when ISP subscribers dial their ISPs' local modem banks, they do so to initiate communications that most commonly terminate out of state and around the world. *See id.* (in the case of ISP dial-up, "there is some communication taking place between the ISP and out-of-state websites"). Thus, nothing in the D.C. Circuit's opinion displaces the Commission's jurisdiction to prescribe an intercarrier compensation rule for ISP dial-up traffic, whether or not the Commission deems that traffic the subject to section 251(b)(5).[2]

II. Removing ISP Dial-Up from the Scope of Section 251(b)(5).

As noted above, section 252(d)(2) presents a potential obstacle to imposing bill and keep on out-of-balance traffic *only* if that traffic is held to come within the scope of section 251(b)(5). If the Commission reaffirms its conclusion that ISP dial-up traffic falls outside section 251(b)(5) because ISP subscribers' Internet-bound communications do not terminate at the ISP's modem bank, then the Commission simply is not constrained by section 252(d)(2).

A. The D.C. Circuit's Opinion in *Bell Atlantic* Does Not Require That ISP Traffic Be Included in Section 251(b)(5).

The *Bell Atlantic* decision held that the Commission had not sufficiently supported its initial determination that ISP traffic is not subject to section 251(d)(5). However, the D.C. Circuit did not base its objections to the *Reciprocal Compensation Declaratory Ruling* on any fundamental disagreement with the substance of the Commission's decision on the merits. Nor

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included in whatever general bill and keep rule the Commission chooses to adopt.

[2] Moreover, the Commission could assert jurisdiction over the residual portion of Internet-bound traffic reflecting communications with *in-state* web servers by finding that there is no practical way for carriers to monitor the destinations of the individual Internet-bound packets they carry or segregate in-state from interstate traffic. *See Louisiana Public Serv. Comm'n v.*

did the Court hold that ISP traffic is, in fact, subject to section 251(b)(5). Rather, the opinion found that the Commission had not adequately justified its reasoning under the Administrative Procedure Act. The Court left open to the Commission the option to revisit and explain its initial decision, fully contemplating that the Commission could well reach the same conclusions. If the Commission does decide to continue to analyze ISP traffic as subject to section 201 rather than section 251(b)(5), it can address the *Bell Atlantic* decision as follows:

1. There is ample Commission precedent for using an "end-to-end" analysis to determine the substantive classification of services as "local." Despite CLECs' arguments to the contrary, the D.C. Circuit did not forbid the Commission from determining the regulatory classification of a service by examining the endpoints of the larger chain of communication of which that service is a part — the approach traditionally used by the Commission in analyzing a service's jurisdictional classification. Instead, the court simply held that the Commission "*has yet to provide an explanation* why this inquiry is relevant to discerning whether a call to an ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs." *Bell Atlantic*, 206 F.3d at 5 (emphasis added).

The D.C. Circuit's conclusion that the Commission had never applied its end-to-end analysis outside of jurisdictional inquiries is simply incorrect. For nearly a decade, the Commission has examined the entire chain of transmission of which a service is a part (and, in particular, examined where that transmission begins and ends) to determine the applicability of substantive rules that turn on whether the service is truly local or merely transits the local exchange network as part of a long distance call. For example, in *Teleconnect Co. v. Bell Tel.*

FCC, 476 U.S. 355, 375 n.4 (1986). The preponderance of commenters confirmed that fact in

Co., 6 FCC Rcd 5202 (1991), *recon. denied*, 10 FCC Rcd 1626 (1995), the Commission used such an analysis to determine the appropriate application of access charges to calls made with Teleconnect's 800 calling card. The Commission looked at the endpoints of these calls to decide whether they consisted of one continuous communication or two separate ones. In determining that there was only one call, the Commission noted that "the end-to-end nature of the communications [is] more significant than the facilities used to complete such communications," and accordingly considered the calling card calls "from [their] inception to [their] completion." 10 FCC Rcd 6 ¶ 12. The Commission has repeatedly applied the same end-to-end analysis to determine the appropriate application of access charges to resold 800 services, *see* Memorandum Opinion and Order, *International Telecharge, Inc. v. Southwestern Bell Tel. Co.*, 11 FCC Rcd 10061, 10069-70 ¶¶ 21-22 (1996), and to a variety of optional services including call waiting, call forwarding, voice mail storage, and paging. *See* Memorandum Opinion and Order, *AT&T Corp. v. Bell Atlantic-Pennsylvania*, 14 FCC Rcd 556, 578-79 ¶ 47 (1998).[3]

The Commission did not cite these precedents in its *Reciprocal Compensation Declaratory Ruling* or its briefs to the D.C. Circuit. A careful explication of these precedents on remand would establish that the use of an end-to-end analysis to exclude Internet-based traffic

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response to the Commission's April 27, 1999 NPRM in this docket.

[3] The Commission has applied an end-to-end analysis to resolve substantive issues in contexts other than access charges as well. In *Request by RCN Telecom Services and Bell Atlantic for Clarification of Bell Atlantic's Authority to Carry Local Traffic Between Exchanges on Behalf of Competitive Local Exchange Carriers*, 14 FCC Rcd 13861 (1999), RCN Telecom and Bell Atlantic petitioned the Commission for a determination of whether section 271 permits Bell Atlantic to transport RCN's calls between two points within Bell Atlantic's local calling area, even though RCN's point of interconnection is located outside of Bell Atlantic's local calling area. In holding that Bell Atlantic could transport such calls, the Commission again focused on "the end-to-end nature of the communication[]," stating that it could "find no reason for why RCN traffic that *begins and ends* within BA's local calling area cannot pass through an interconnection point outside of the BOC's local calling area." 14 FCC Rcd at 13866 ¶ 13 (emphasis added).

from section 251(b)(5) in fact comports with longstanding agency practice, and that it would have been error *not* to apply an end-to-end analysis here.

2. Internet-bound dial up traffic does not "terminate" at the ISP's modem bank within the meaning of the Commission's rules. The Commission's second error, according to the D.C. Circuit, was its failure "to apply, or even to mention, its definition of 'termination,' namely 'the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party's premises." *Bell Atlantic*, 206 F.3d at 6 (quoting 47 C.F.R. § 51.701(d)). Again, the Commission can easily correct any failure of explanation on remand.

First, it appears that the D.C. Circuit misread 47 C.F.R. § 51.701(d), the Commission definition of "termination" in question. On its face, that rule is not intended to define the local traffic subject to section 251(b)(5); rather, it applies only *after* the traffic has been determined by the Commission based on *other* rules to be "subject to section 251(b)(5)." 47 C.F.R. § 51.701(d). The point of the Commission's rule is simply to classify the universe of section 251(b)(5) traffic as one of two services: "termination" as opposed to "transport." *See* 47 C.F.R. § 51.701(c) (complementary definition of "transport"). The Commission was correct to consider this rule irrelevant; should it choose to reaffirm this conclusion, it need only explain why.

Second, ample Commission precedent confirms the technical reality that ISP's local modem bank is not the "called party" that the ISP subscriber ultimately aims to reach, and hence the call does not "terminate" with the ISP under any permissible reading of that word. The Commission has consistently defined the "called party" in terms of the caller's intention, and it has ruled multiple times that when a caller first dials a "local" telephone number to reach an intermediate platform before directing his call to its final destination, the intermediate platform is not a "called party." *See, e.g., Teleconnect Co. v. Bell Tel. Co.*, 10 FCC Rcd 1626, 1627, 1630 ¶¶ 5, 14 (1995) (long distance platform reached through an 800 number); Memorandum Opinion and Order, *Petition for Emergency Relief and Declaratory Ruling Filed by the BellSouth Corp.*, 7 FCC Rcd 1619, 1620, 1621 ¶¶ 9, 11 (1992) (voice mail); *cf. Local Competition Order*, 11 FCC Rcd at 15935 n.2091 (discussing operation of Feature Group A).[4] An ISP subscriber does not dial a local telephone number because he wants to speak to the ISP's modem bank; rather, he does so to connect to the servers *beyond* that modem bank, that contain the content of the Internet.

3. *ISPs are fundamentally different from businesses that use the telephone just as part of their operations.* The D.C. Circuit noted that the Commission "ha[d] not satisfactorily explained why an ISP is not . . . simply a communications-intensive business end user selling a product to consumer and other business end users." *Bell Atlantic*, 206 F.3d at 7 (internal quotation marks omitted). Again, the court held only that the Commission had not *explained* the difference between an ISP and a pizza-delivery firm, not that it *could* not provide such an explanation. The Commission has since articulated the missing explanation (indeed, to the same court that decided *Bell Atlantic*, and to two of the same three judges) in its recent brief defending the *Advanced Services Remand Order*:

> Moreover, ISP-bound traffic differs decisively from calls to other businesses that use telecommunications, such as "pizza delivery firms, travel reservation

[4] The D.C. Circuit suggested that the *Teleconnect* and *BellSouth* precedents might not apply because ISPs provide "information services," *see Bell Atlantic*, 206 F.3d at 6, but this concern is misplaced. The Commission has applied this same understanding of where communications begin and end to ESP services, of which ISP services are simply a subset. As the Commission has explained, a call to an ESP is an "interstate call[] which *transit[s the ESP's] location*" on the way to its final destination. Memorandum Opinion and Order, *MTS and WATS Market Structure,* 97 F.C.C.2d 682, 711-12 ¶ 78 (1983) (emphasis added). Even if an ESP "might terminate a few calls at its own location," the Commission recognized, most of the calls it receives will "transit its location" and continue on to interstate destinations. *Id.* at 712 ¶ 78.

> agencies, credit card verification firms, or taxicab companies." [Citation omitted] Those businesses might place separate calls of their own to assist the customers that have called them; for example, a taxi dispatcher ordinarily takes one call from a customer before placing a separate call (to which the customer is not usually a party) to a taxi driver. As a general matter, those businesses do not provide their customers with anything remotely resembling what an ISP provides: a service supplied by means of a seamless, real time transmission between the customer himself and interstate or foreign Internet sites to which the customer seeks access.

Brief for Respondents at 55, *WorldCom, Inc. v. FCC*, No. 00-1002 (D.C. Cir. Feb. 21, 2000). The Commission now can and should turn this argument from a litigation submission into a formal holding.

B. The Commission May Regulate ISP Dial-Up Traffic Under Section 201.

If the Commission does reaffirm on remand that Internet-bound calls are not governed by section 251(b)(5), the Commission may then use its general power over the "charges" for interstate traffic (47 U.S.C. § 201) to prescribe an intercarrier compensation rule for ISP dial-up, just as it used that authority to adopt compensation rules to govern where two LECs collaborate to carry a call to an IXC. *See* Third Report and Order, *MTS and WATS Market Structure*, 93 F.C.C.2d 241, 254-55 ¶¶ 37-41 (1983) (citing authority under section 201(a) to regulate jointly provided interstate access). Indeed, the Commission had previously used this same authority to adopt an interim bill and keep rule for CMRS traffic. *See* Notice of Proposed Rulemaking, *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, 11 FCC Rcd 5020, 5023 ¶ 3 (1996); Notice of Proposed Rulemaking and Notice of Inquiry, *Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services*, 9 FCC Rcd 5408, 5455-56 ¶ 113 (1994).

Adopting a bill and keep rule for Internet-bound traffic under section 201 would conform with longstanding Commission precedent.[5] When an ordinary long distance call transits two LECs' networks on its way from the local caller to an interstate service provider (or vice versa), Commission precedent deems the LECs to be *co*-providers of the interstate carrier's access service, and the LECs *share* both the costs of access and the access revenues from the interstate provider. *See Reciprocal Compensation Declaratory Ruling*, 14 FCC Rcd at 3695 ¶ 9 ("When two carriers jointly provide interstate access (*e.g.*, by delivering a call to an interexchange carrier (IXC)), the carriers will share access revenues received from the interstate service provider."); Memorandum Opinion and Order, *Investigation of Access and Divestiture Related Tariffs*, 97 F.C.C.2d 1082, 1176-77 (1984) (rejecting mandatory single-carrier billing for jointly provided access services).[6] ISPs also are interstate service providers, but unlike ordinary long-distance carriers, ISPs are currently exempt from paying carrier access charges, other than the relatively small special access surcharge. Hence, there is no (or relatively little) carrier access revenue for the two LECs serving the ISP to divide.[7] A bill and keep rule is equivalent to finding that the two LECs serving an ISP are co-providers of the ISP's local dial-up connections, but that there is no carrier access revenue that the two LECs should share. As discussed in more detail in Appendix A below, this course of action has already been well vetted in the most recent round of

[5] It is important to recognize that section 251 expressly recognizes and preserves Commission authority under section 201. *See* 47 U.S.C. § 251(i).

[6] *See also* Memorandum Opinion and Order, *Access Billing Requirements for Joint Service Provision*, 4 FCC Rcd 7183, 7185-86 ¶¶ 21-26(1989); Memorandum Opinion and Order, *Waiver of Access Billing Requirements and Investigation of Permanent Modifications*, 2 FCC Rcd 4518, 4519 ¶ 7 (1987).

[7] The Commission may decide that the amount of special access surcharges at issue is too small to justify the administrative costs required to track and share these amounts. *See Local Competition Order*, 11 FCC Rcd at 16055 ¶ 1112 ("bill-and-keep arrangements may minimize

comments in this docket, and the Commission could easily pursue this course without further notice and comment.

C. The Commission May Regulate the Remaining Wireline Traffic Under Section 251(b)(5).

Once ISP-bound calls are taken out of the mix, the Commission would be free to address genuine local traffic pursuant to the provisions of sections 251(b)(5) and 252(d)(2) and its existing rules. Thus, the Commission could adopt a bill and keep structure for such traffic with little difficulty, upon a finding that the remaining traffic flows between wireline LECs are "roughly balanced." *See Local Competition Order*, 11 FCC Rcd at 16055 ¶ 1113. (As we discuss in Appendix B below, certain types of local traffic may not properly be subject to bill and keep and should be addressed separately.) The net result would be a bill and keep structure that applies to both ISP and non-ISP traffic, although the Commission would be basing the bill and keep approach in each instance on a different source of statutory authority.

To adopt a bill and keep rule for non-ISP traffic in this proceeding, the Commission would have to determine that the record before it to date provides parties with sufficient notice of that possibility. We address this question in Appendix A.

III. Including ISP-Dial Up in Section 251(b)(5).

As noted above, the Commission should be able to implement bill and keep for Internet-bound traffic (and other wireline traffic) if the Commission reverses course and rules that ISP dial-up traffic *is* covered by section 251(b)(5). But in this case, as discussed above, any compensation rule would have to comply with section 252(d)(2). We see three possible

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administrative burdens and transaction costs," even where the amounts of compensation due between carriers would not be precisely equal).

approaches that the Commission could use to adopt bill and keep for ISP traffic consistent with sections 251(b)(5) and 252(d)(2).

A. Implement Bill and Keep Based on Ordinary Principles of Cost Causation by Finding That the Costs of ISP Dial-Up Are "Associated" with the ISP, Not the ISP's Subscribers.

As the economic analyses provided by Qwest and other parties demonstrate, in the context of ISP dial-up it is the ISP — in particular, the pre-existing relationship between the ISP and its own subscribers — and not the ILEC residential subscriber that is the true economic causer of the CLEC's call termination costs. It is not an unexpected fortuity that so many calls reach the lines of a CLEC serving an ISP; rather, it is an inherent and expected aspect of providing service to that ISP customer, and indeed, the sole function for which the CLEC receives compensation from the ISP.

As the CLEC is fully aware, ISPs offer their own subscribers a product that is integrated with and usable only in conjunction with telephone access. As Bill Taylor of National Economic Research Associates explained in an *ex parte* to the Commission, the most appropriate way to view a person making an ISP dial-up call is

> as an [ISP] customer placing an Internet-bound call, not a[s an ILEC] customer placing a local call. Although the portion of her Internet call that lies entirely within the circuit-switched network . . . *resembles* a local call, its economic function is very different, since [the ISP] is not simply a passive end-user recipient of her call. Rather, [the ISP] designs, markets, and sells [the caller] the service, collects her monthly fee for Internet access, answers her questions, establishes telephone numbers at which she can access its services without paying toll charges, and pays the CLEC for access to the public switched telephone network. Moreover, [the ISP] performs standard carrier functions such as transport and routing, as well as maintains leased facilities within the backbone network. [The ILEC] and the CLEC simply provide access-like functions to help the Internet call on its way.

William E. Taylor, et al., *An Economic and Policy Analysis of Efficient Intercarrier Compensation Mechanisms for ISP-Bound Traffic* at 5 ¶ 12 (Nov. 12, 1999) (emphasis in original) (quoted in Comments of Qwest).[8] *See also* Initial Commission Decision, *Petition of Sprint Communications Co., L.P., for Arbitration Pursuant to U.S. Code § 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with U S WEST Communications, Inc.*, Dkt. No. 00B-011T, at 14 (Colo. Pub. Utils. Comm'n May 3, 2000) (adopting bill and keep for ISP-bound traffic because "[w]e view the originator of the Internet-bound call as acting primarily as a customer of the ISP, not as a customer of U S WEST"). In this sense the ISP uses the LEC's and the CLEC's service much as an IXC does, and it would be economically reasonable for an ISP, like an IXC, to compensate the LEC and CLEC for the access they jointly provide.[9] In lieu of this, however, a bill and keep structure is the most rational approach.

A CLEC that targets an ISP and agrees to provide it with the dial-up access portion of its offering thus understands that its primary role as a carrier will be to terminate large volumes of traffic to that ISP from the ISP's subscribers. The CLEC knows what the ISP's business is, and the CLEC is fully aware of the costs it will face from its choice to serve that customer. Those costs are not *imposed* on the CLEC by the residential subscribers' carrier; rather, they are *caused* by the ISP and *assumed* by the CLEC in its choice to serve that ISP customer. The CLEC does or can account for those costs in the rates it charges the ISP. It unquestionably is more efficient and consistent with economic principles of cost causation for the ISP itself to bear these costs under its contract with the CLEC and to factor them into its cost of doing business, rather than

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[8] All comments and reply comments cited herein were submitted in response to the Public Notice which followed the D.C. Circuit's remand of the *Reciprocal Compensation Declaratory Ruling*. Comments were filed on July 21, 2000, reply comments on August 4, 2000.

[9] Indeed, the ISP already compensates the CLEC for such access in whatever service charges it pays the CLEC, which provides the ISP with only that one service -- access; thus,

force these costs on non-Internet-using incumbent LEC ratepayers via reciprocal compensation payments to the ISP's carrier. Indeed, the Commission has stated that it would expect an incumbent LEC choosing to serve a customer with high inbound call volume to bear and adjust its own rates to reflect the termination costs caused by serving that customer, *see Access Charge Reform*, 12 FCC Rcd 15982, 16134 ¶ 347 (1997), and there is no reason why the same expectation should not apply to a CLEC serving that same customer. Any intercarrier compensation rule for ISP dial-up traffic should therefore reflect that the ILEC serving the ISP's subscribers is not the causer of the CLEC's costs.

This approach is consistent with section 252(d)(2). As noted above, section 252(d)(2) requires that compensation arrangements negotiated under section 251(b)(5) "provide for the mutual and reciprocal recovery by each carrier of costs *associated with* the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier." 47 U.S.C. § 252(d)(2)(i) (emphasis added). The Commission can find on the basis of the comments submitted in this proceeding that the costs of terminating Internet-bound traffic are *not* "associated with" the transport and termination of ordinary local traffic originated by various incumbent LEC subscribers; rather, they are "associated with" the ISP's primary business offering, which includes dial-in capability as an inherent component. Likewise, the CLEC's costs are "associated with" its choice to serve that ISP and provide the dial-in capacity that the ISP requires. The Commission could accordingly implement a bill and keep rule for all ISP-bound traffic without concern that it was failing to accord recovery of any costs mandated by section 252(d)(2).

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reciprocal compensation paid to the CLEC for serving the ISP would constitute double recovery of the CLECs' costs.

Nothing in section 252(d)(2) reverses ordinary principles of cost causation or suggests a legislative determination that costs shall be deemed to be "caused" by the ILEC no matter what true economic cost principles would dictate. At the same time, however, the Commission has never proffered an interpretation of "association" language under 252(d)(2). This approach would require that the Commission affirmatively embrace cost causation as a guiding principle under sections 251(b)(5) and 252(b)(2). Moreover, applying strict cost causation principles could change the dynamics of serving not just ISPs but all ESPs, and perhaps other entities as well. The Commission should consider these questions in analyzing this approach; it is an approach that would well serve both the public interest and the intent of Congress when it adopted section 252(d)(2).

B. Limit Reciprocal Compensation to Genuine Two-Way Carriers.

By its plain language, section 251(b)(5) obligates LECs only "to establish *reciprocal* compensation arrangements for the transport and termination of telecommunications." "Reciprocal" arrangements can exist only where carriers are exchanging traffic with each other in both directions. Section 251(b)(5) does not address the situation where a LEC intentionally restricts its operations and the customers it serves to create an aggregate traffic flow that is by design not reciprocal. CLECs that serve a mix of customers should have an overall aggregate return traffic flow that is not grossly disproportionate to the traffic sent to it by the LEC. However, a CLEC serving only or primarily ISPs likely will have minimal return traffic flows, creating a significant imbalance.

The Commission could adopt bill and keep for all wireline traffic by finding that carriers that intentionally limit their operations to engineer unidirectional traffic flows have no legal entitlement under section 251(b)(5) to demand *reciprocal* compensation arrangements. To be sure, the proposed rule could easily be evaded and may have unanticipated implications for carriers serving other customers with traffic flows that tend to be uni-directional; this would have to be analyzed carefully. One approach the Commission might consider is identifying and establishing a non-*de minimis* threshold for return traffic (considering all the CLEC's circuits) for any CLEC seeking to qualify for reciprocal compensation. The critical challenge would be to craft a rule that would prevent a CLEC from defeating the rule simply by serving a token number of residential subscribers.

As noted above, the Commission would have jurisdiction to prescribe an intercarrier compensation rule for carriers that do not meet the threshold, since the D.C. Circuit did not disturb the Commission' end-to-end jurisdictional analysis of ISP dial-up traffic. But because this rule would be based on section 201 rather than section 251(b)(5), the Commission would not be bound by the requirements of section 252(d)(2), and could impose a bill and keep rule for such traffic even though it would not be in balance.[10] On the other hand, LECs that do not restrict who they serve and that exchange significant volumes of traffic in both directions *would* be entitled to reciprocal compensation under section 251(b)(5) — and for *all* the wireline traffic they exchange, including ISP dial-up traffic, subject only to certain limitations explained in Appendix B below. The Commission could make a specific finding on the basis of the record in this docket that the traffic flows among such carriers are roughly balanced. As laid out above, under section 252(d)(2) and the Commission's existing rules, mandatory bill and keep is a permissible and appropriate compensation rule for such balanced traffic.

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[10] The Commission could also take the approach of adopting a rebuttable presumption that a bill and keep regime is appropriate unless a carrier can demonstrate that such a structure is not justified; however the Commission would have to clarify that an intentional traffic imbalance caused by serving ISPs exclusively or primarily is not sufficient to overcome the presumption.

Such a position could be seen as inconsistent with the Commission's earlier holding, in the context of wireline LEC-CMRS interconnection, that "*any* telecommunications carrier[]" has a right to establish reciprocal compensation arrangements with a LEC. *Local Competition Order*, 11 FCC Rcd at 16016 ¶ 1041 (emphasis added). The Commission would have to be able to draw a defensible line between ISP-only CLECs and CMRS carriers. Such a distinction would be reasonable: CMRS carriers do not intentionally restrict the customers they serve simply to create traffic imbalances and exploit regulatory anomalies; any traffic imbalances between CMRS and LEC networks is a function of the nature of the service the CMRS providers offer and the way subscribers use such services. The Commission would be justified in holding that wireline LECs that exploit the Act's market-opening provisions to *create* traffic anomalies that otherwise would not exist are not entitled to a presumption that they engage in "reciprocal" exchanges of traffic — especially when their actions in fact thwart the purposes of section 251 by affirmatively discouraging the extension of facilities-based competition to residential subscribers.

C. Forbear from Applying Section 252(d)(2).

In the alternative, the Commission could choose to forbear from the application of 47 U.S.C. § 252(d)(2) to ISP-bound traffic. Section 10(a) of the Act (47 U.S.C. § 160(a)) directs the Commission to "forbear from applying any . . . provision of this Act to a . . . class of telecommunications carriers or telecommunications services" where the Commission determines that (1) the provision is not needed to guard against unreasonable carrier practices, (2) the provision is not needed to protect consumers, and (3) forbearance would be in the public interest. The Commission could avoid the legal difficulties of imposing bill and keep on out-of-balance Internet-bound traffic by forbearing, for this particular "class of . . . telecommunications services," from enforcing section 252(d)(2)'s requirement that transport and termination rates afford carriers a mutual recovery of their additional costs. As discussed above in Part III.A, the Commission could generally apply bill and keep to the remaining traffic by finding that it is roughly balanced.

Although the Act gives carriers the right to petition the Commission for forbearance, *see* 47 U.S.C. § 160(c), the Commission may exercise its forbearance authority *sua sponte* without waiting for carriers to file a petition. *See, e.g.*, Notice of Proposed Rulemaking, *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 11 FCC Rcd 7141 (1996) (launching section 10 proceeding on IXC detariffing without requiring the filing of a petition under section 10(c)). The Commission should be able to make all of the necessary findings for forbearance on the record of this proceeding:

- Enforcement of section 252(d)(2) is not "necessary to ensure that the charges, practices, classifications or regulations" of carriers in connection with ISP dial-up traffic "are just and reasonable and not unjustly or unreasonably discriminatory." 47 U.S.C. § 160(a)(1). In this case, forbearance is necessary to *prevent* carriers from imposing unjust and unreasonable charges on incumbent LECs and local exchange ratepayers.

- Enforcement of section 252(d)(2) is not "necessary for the protection of consumers." *Id.* § 160(a)(2). In the absence of forbearance, local exchange consumers are harmed by being forced to subsidize CLECs (and their ISP customers) that do not to serve them — indeed, that are affirmatively discouraged by the current rules from doing so.

- Finally, forbearance "is consistent with the public interest," *id.* § 160(a)(3), and will "enhance competition among providers of telecommunications services." *Id.* § 160(b). The payment of per-minute transport and termination charges for ISP dial-up causes massive market distortions, stunts competition for residential customers, and discourages carriers from building out their networks broadly. Forbearance would enhance competition by encouraging all carriers to compete for all customers, and to do so on the basis of price and service quality rather than regulatory advantage.

By grounding its resolution of the ISP reciprocal compensation question on an exercise of section 10 forbearance power, the Commission would also have a clear source of authority for preventing states from issuing contrary decisions. Once the Commission forbears from enforcing a provision of the Act under section 10, the Act expressly forbids the states from continuing to apply that provision. *See* 47 U.S.C. § 160(e).

One potentially significant limitation to this approach is that the section 271 checklist specifically requires BOCs to offer "[r]eciprocal compensation arrangements in accordance with the requirements of section 252(d)(2)." 47 U.S.C. § 271(c)(2)(B)(xiii). To permit the BOCs to implement any bill and keep rule that the Commission adopts, the Commission would additionally have to rule that section 252(d)(2) no longer imposes any "requirements" once the Commission forbears from it. Alternatively, the Commission could forbear from enforcing the section 271 checklist's cross-reference to section 252(d)(2); however, the Commission has previously taken the view that it is prohibited by section 10(d) from forbearing from any provision of section 271 until that section is fully implemented. *See* 47 U.S.C. § 160(d); Memorandum Opinion and Order and Notice of Proposed Rulemaking, *Deployment of Wireline*

Services Offering Advanced Telecommunications Capability, 13 FCC Rcd 24011, 24047-48 ¶ 77 (1998). This interaction with section 271 may limit the utility of any forbearance approach.

Conclusion

The Commission has several options before it, any of which might allow it to adopt a defensible bill and keep structure for ISP-bound traffic, as well as some broader class of traditional local traffic as appropriate. If the Commission reaffirms its earlier conclusion that ISP-bound traffic is not subject to section 251(b)(5), the Commission may base its intercarrier compensation for ISP traffic on its authority under section 201, free from any constraints imposed by section 252(d)(2), while imposing bill and keep on the remaining (roughly balanced) traffic under section 251(b)(5). The Commission could also adopt bill and keep if it reverses course and *includes* ISP dial-up in section 251(b)(5), by making the careful findings described above regarding the economic and statutory grounds supporting such an approach, and confronting the various remaining issues that the various options would present. A well-reasoned decision on such grounds should withstand judicial scrutiny and eliminate the gross inequities of today's circumstances.